Anatomy of commingled funds: Untying the knots with new theory

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Assets are considered *commingled* when a single asset or a single account contains marital and non-marital portions. When the marital and non-marital portions are just money, they are indistinguishable from each other. We use the term *fungible* to describe this. *Tracing* is an unbiased method used for demonstrating where funds went. We often consider showing that the assets have distinct characteristics as synonymous with tracing. While often true, it is not always and so leads to confusion. If one can show that the marital and non-marital portions have separate characteristics, then one can successfully trace where the non-marital funds were at all times. This is generally sufficient as proof that a gift was not intended.[1] Reasoning that if a statement is true, its contra positive is also true, some courts have held that if the funds cannot be traced, then there must have been intent to gift those funds.[2] There are two problems with this conclusion. The most obvious is that the courts accept other forms of proof.[3] Thus, while tracing is sufficient to overcome a presumption of a gift, it is not necessary. This by itself invalidates negating and reversing the order of the statement as a true contra positive. It also ignores the original theory that commingling funds inside a joint account creates the presumption of an interspousal gift.[4]

A presumption of a gift is created only when the title of the non-marital asset changes to include the names of either spouse or when non-marital funds are deposited to a jointly titled account.[5] We can sometimes show where the non-marital funds were at all times without demonstrating separate characteristics.[6] We can do this even with fungible non-marital and marital assets combined inside a joint account.[7] We can trace funds that are fungible when they are deposited to a joint account and the exact amount of money is withdrawn only days later and used to purchase a non-marital asset or to pay for a non-marital liability[8]. When this occurs it is clear where the non-marital funds were at all times. Thus, it is important to understand that when the marital and non-marital funds are indistinguishable from each other, they will often be untraceable; but this is not always so. The Fifth and Fourth District Courts of Appeal have confused fungible assets with untraceable assets when they attempted to separate actively earned funds from their passive component. This led to incorrect rulings that any marital effort that results in appreciation converts the entire appreciation of the non-marital asset into marital property.[9] These courts have only recently understood that this is incorrect.[10] This article will show that other district courts are extending this same confusion to traceability of assets and whether an interspousal gift applies to the transaction.[11]

Creating an interspousal gift

A line of cases has determined that when non-marital funds are either deposited to a joint account or retitled to include the other spouse's name that the transaction creates a presumption of an interspousal gift.[12] This presumption may be overcome by showing that a gift was not intended.[13] One of the ways to prove this is to demonstrate that the commingled non-marital portion can be traced from the date it was mixed with marital funds.[14] Yet tracing is a word of art used in many different contexts in family law. When it is used for describing the requisite proof for showing that no gift was intended when liquid funds are commingled, it often means that one must show that the traced portion has distinguishing characteristics from the other portion.[15] Otherwise, since money is fungible, unless the distinguishing characteristics can be demonstrated, the marital portion has lost its separate character from the non-marital portion.[16] But this conclusion converts the non-marital funds into marital property only when the issue of a presumptive gift is raised as a result of the transaction.

A recent case decided by the Fifth District Court of Appeals has determined that titling alone does not cause a presumption of a gift.[17] It found that intent is not determined by changing the title of the non-marital asset alone, but is also determined by the actions that follow. This opinion is erroneous because the facts surrounding the intent are an element of whether the party seeking to show that gifting is not intended can prevail. The opinion embraces circular reasoning. Section 61.075(5)(a)(3), F.S., provides that marital property includes interspousal gifts of non-marital property. But, under what circumstances has a gift been created? Transactions are not labeled as gift or non-gift. A particular transaction can suggest a gift. When a spouse brings assets to the marriage that are kept separate, there is certainly an expressed intent to treat those assets as non-marital property. When the title of the separate assets is changed to include the other spouse and that spouse has equal control over that asset, the transaction implies a gift. This implication creates a presumption. The surrounding facts are then examined before concluding that a gift occurred. When one party offers unrebutted testimony that the transaction occurred for other than gifting purposes, that proof overcomes the presumption and the inquiry ends there. By interchanging the elements of the proof with what creates the presumption of a gift, as the Fifth DCA does with *Crouch*, an interspousal gift has been expanded to include commingled assets inside any account.[18] This includes assets that are titled solely in one name.[19]

It also includes assets owned by a trust. Both conclusions are incorrect and result from circular reasoning. To conclude otherwise, one must conclude that a deliberate attempt to convert marital property into non-marital property is a presumed intent to gift the non-marital property to the other spouse. Right!

Section 61.075(7) defenses to Section 61.075(5)(a)(3)

When non-marital funds are deposited to a joint account and maintained in the account for a very short period of time, this has been cited as acceptable proof that no gift was intended.[20] The courts reason that there was little time for earnings to accrue or any other expenses to be paid, thereby rendering the issue of commingling moot. Yet what difference does this make when the non-marital funds are inextricably commingled with marital funds? The liquid non-marital funds are fungible and, once deposited into marital funds, they become indistinguishable from each other. Once again, circular reasoning is employed to reach a correct result. The funds are traceable only as to intent, not whether the same funds are used to purchase the non-marital asset. The small amount of time limiting the amount of earnings has nothing to do with the Section 61.075(7) proof. If there is an intended purpose other than gifting, the funds likely will be moved fairly quickly. But the fact that they are moved quickly does not invalidate the proof. The fact that there is a deposit and a withdrawal of an identical amount of money proves a design and goal for that exact amount of money apart from gifting.[21] Naturally, the offered proof is questionable if the money sits in the account for a very long period of time. The amount of time that is reasonable for the transaction is linked to the contemplated investment and the reason for the delay and not to any earnings or investments made in the interim period.

Effect of commingling funds when gifting is not intended

If no presumption of gifting is raised, then the party seeking a classification of the original property as non-marital still has a burden to demonstrate a non-marital portion.[22] To satisfy this latter burden, the court routinely accepts any reasonable method, and it does not require tracing the non-marital funds.[23] Yet the case law emerging over the past few years shows the confusion between the two burdens. This led the Fourth District Court of Appeals to first conclude that the infusion of marital effort or funds into a non-marital closely held business transmuted all of the appreciation of the company stock into marital property.[24] When challenged with an ability to separate active and passive efforts in *O'Neill*, the Fourth District receded from this line of cases.[25] Yet most trial courts of Florida's east coast as well as those situated in the First, Third and Fourth District Courts of Appeals continue to apply a perceived inability to separate the two forms of appreciation with a non-marital house. This is why they follow the formula set forth in *Landay v. Landay*, 492 So.2d 1197, 1198 (Fla. 1983)[26], which allocates most of the appreciation in the home to the marital years even though its contribution is minimal.[27] Accordingly, it is possible to calculate a marital and non-marital component even when it is impossible to separate the non-marital portion and its passive component by demonstrating that each has separate characteristics.

Other cases have determined that when marital and non-marital funds are combined, unless the original funds can be traced (with separate characteristics), they are indistinguishable from the marital funds.[28] This conclusion is obvious and does not merit discussion. However, error occurs when the same courts go further to conclude that it is therefore impossible to determine from which of the two ledger accounts expenses are paid or earnings accrue, and therefore the party seeking to demonstrate a non-marital portion cannot prevail. Applying this incorrect reasoning to a family run business led to the *Robbie* conclusion. The Fourth DCA only recently receded when challenged in *O'Neill*. One thing is certain, however. Regardless of the motivation for combining the funds, the physical act of combining them is presumed intentional, yet it is a stretch in logic to conclude that interspousal gifting is the spouse's motivation for doing it.

The trial courts and the experts who testify before them mix up the two distinct burdens, and this has led to the confusion. In fact, this confusion is so prevalent that CPAs often attempt to separate marital and non-marital components of defined contribution plans by tracing the non-marital investments from the date when the parties married (as a means for determining a non-marital portion). This is absolute nonsense because the whole point behind tracing is to do so when the spouse who owned the account had the ability to combine the funds. Such is not the case with most corporate retirement plans. The assets of the account are owned by the trust, and only the company appointed plan administrator (designated in the pension trust) can make these decisions. Yet regardless of the motivation for doing it, the effect is the same: It creates a new asset from which the individual and the marriage have a stake. It does not show an intended gift any more than using marital funds to pay the mortgage of a non-marital house does. We do not inspect the non-marital house to see for what portion of the structure the marital funds paid.

The appellate opinions do not grasp the concept of a single fungible asset that preserves marital and non-marital components. They certainly would understand the concept better if they attempted to reconcile how mutual funds can separate millions of shareholder interests accurately when the fund is a fungible composite of many different investments. They certainly would begin to understand the concept when they are routinely provided testimony separating fungible assets of a defined contribution trust. Retirement assets are fungible assets that preserve non-marital portions without a requirement to trace them. The retirement trust

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owns both portions. Thus, when the *O'Neill* court concluded that it lacked evidence to determine whether the trial court abused its discretion in finding that the retirement assets were actively managed, it failed to apply the law to a single fungible asset, the retirement plan. How could any trial court find that a retirement asset is actively managed when it cannot determine whether the effort it rules is active is applied to the marital portion of the asset or the non-marital portion? The trial court by making that finding contemplates two distinct assets when there is only one. As one asset, both components appreciate by the same percentage. As two separate and distinct assets, each portion increases by its investments. In other words, each portion has separate characteristics. This is not possible when the trust owns the assets, and the employee only has rights to benefits from the trust.

Yet the concept of one fungible asset with two distinct portions is not unique to liquid funds. Creating one asset with two portions also happens when marital funds pay down the mortgage of a non-marital house. It also occurs with a non-marital business in which the owner adds marital property. Gifting is never raised as an issue with these assets unless the titling of the asset changes. Why then is it raised in the context of funds?

The reasoning in the reported decisions appears to be that different funds are indistinguishable from each other and are "fungible." Yet in the above examples, one cannot partition a house or business into two separate components with distinguishing characteristics, and retirement plans involve the same kind of "fungible" funds with bank accounts and liquid securities. If the intent of depositing marital funds into a non-marital account is to make the two sources of funds work as one, when the owner of the non-marital portion expends funds from this mix each expense involves a payment from each component in the same way that marital and non-marital ledger allocations increase by the same percentage of appreciation inside a retirement plan. This is the practical effect of what is intended when the funds are mistakenly combined. This is especially true when the party who deposits the paycheck into the non-marital account mistakenly believes that these funds are his or her separate property. The erroneous conclusion is only a mistake as to how marital law applies. The only intent that can be inferred from this mistake is to treat the two assets as *one* fund and not two. It is a great leap in logic to conclude that this action contemplates a presumption of gift. Accordingly, the reasoning of the case law that the party cannot demonstrate the portion from which the funds were expended misses the entire point that combining the funds was intentional. While this same principle is at work when funds are combined inside a joint account, the difference is that a presumed gift occurs when a party changes the titling on the non-marital account to include both names. The significance that traceability has when this occurs is only that if combining two distinct assets was not intended, steps would have been taken to keep the non-marital source separate from the marital. While most fail to keep the funds separate because they fail to understand the impact of combining the funds, the controlling point is that the party who made these decisions has the burden to demonstrate the contrary intent when those actions imply a gift, not when they do not.

To better understand why intent to combine the two inside a separately titled account does not destroy the non-marital portion, we need to ask ourselves certain questions about the resulting marital and non-marital portions if the moneys had not been combined. Certainly marital expenses can be paid with non-marital funds. This is easily accomplished when the funds expended come from a separately titled account that existed before the marriage commenced. Similarly, marital funds can be used to pay non-marital expenses without a court finding that party dissipated marital assets. Since both are clearly possible, it is certainly possible to pay part of the marital expenses with marital funds and the balance with non-marital funds.

The significance attached to intentionally combining funds

In each of the above contrasting examples, the owner of the asset either lacked ability to keep the portions separate, or it was very impractical to do so. The owner of the business would have to hire an unrelated party to run the business and would have to give up daily control of its operations. This would either invite theft from the business income or require the sale of the business to

prevent this. The owner of the house would need separate non-marital funds to pay the mortgage during the marriage. This is because one cannot partition the structure of the house between marital and non-marital ownership. A requirement to pay the mortgage with non-marital funds is the same as requiring that the house be unencumbered when entering the marriage. This would require a separate source of funds from which upkeep and taxes are paid during the marriage. The participant of a retirement plan does not even own the investments made before the marriage begins; the trust that sponsors the plan does. Thus, when funds are intentionally combined outside a retirement plan structure (and did not have to be), that person loses the right to claim that the non-marital portion *works* as a separate asset. That does not translate into losing the non-marital portion of the combined asset any more than it does with a house, business or retirement plan. Therefore, when funds are intentionally combined into a separately titled account, the party who combined them loses the ability to claim that marital and non-marital expenses are paid exclusively from the infusion of the marital funds (although its value necessarily will be less). It pays them from the combined funds, and each payment contains a portion of each. As long as the transactions are limited to payment of marital expenses, there is no issue that a non-marital portion cannot be determined.

For example, if on the transactional date the marital funds represent 30 percent of the value of the two, the earnings that accrue are credited to both portions so that the marital portion is always 30 percent of the asset. This will continue in this fashion until new marital money is added. This is what happens with a retirement asset that contains marital and non-marital components. Adding new marital money would increase the percentage that is marital property determined by the values on the date that the addition is made. This is exactly the way the marital portion of the retirement benefit works. Disbursements that are used to pay marital expenses preserve the percentage that is marital after the disbursement is made. Complications may arise if the expenses paid are non-marital, because including a marital component in the payment raises possible issues of dissipation of marital assets if the other spouse did not know about or was powerless to stop it. This is curable when applicable by letting the non-marital portion bear the total expense even though the intent may have been to have the entire fund pay that portion from the two sources. The effect of combining the funds without retitling the non-marital portion is effectively the loss of the right to treat the non-marital portion as a separate asset. Loss of this right does not confer an interspousal gift of the non-marital money any differently than marital contributions added to a non-marital 401(k) benefit does. If, on the other hand, the intent was not to merge the two distinct assets into one, then that party may be required to trace the non-marital portion to show the contrary intent. If the party can show the contrary intent with convincing evidence, then marital expenses could be paid exclusively from the marital portion. The lesser marital portion could be determined with the dollar weighted method. This method treats the asset as one and preserves the portions as separate and allows the marital expense to be deducted from the marital share. It does this by weighting the accrued earnings or loss thereof with the duration of the dollar amount invested. Since intent is not an issue with each portion inside a defined contribution plan, this method (used by actuaries and investment firms) is ideally suited to calculate a non-marital portion of these assets.

Active effort rulings are inconsistent with commingling rulings

It was shown above why the combining of marital and non-marital funds inside non-marital accounts does not convert the entire account into marital property. This conclusion can be further supported with the appellate rulings that examine when marital effort converts the appreciation of a non-marital asset into marital property.[29] Earlier rulings show that marital effort becomes active marital effort when one party challenges whether the appreciation is passive and the other party fails to show why it is passive. This conclusion by itself surely leads to the commingling of marital and non-marital assets: The non-marital component before commingling is the original asset. The marital component is created with the appreciation that results from actively managing the non-marital asset. When the owner of the original asset cannot demonstrate a portion of the earnings that is passive appreciation, this failure makes the entire appreciation marital property.[30] Yet this conclusion does not destroy the non-marital portion, only the non-marital portion of appreciation on the non-marital asset.[31] This shows clearly that combining marital and non-marital assets inside a non-marital account still preserves the "principal" non-marital portion even though it is indistinguishable from the marital portion because it fails to have separate characteristics. This further shows that commingling funds absent a gifting presumption can never reduce the original non-marital portion, which is principal. To the extent that some money was expended, the non-marital portion could never be less than the original principal less the money expended.

Recent opinions have acknowledged that appreciation resulting from active effort can contain a non-marital component classified as passive income.[32] Both active and passive appreciation components are reinvested and accumulate more earnings. They are indistinguishable from each other and the original principal by their characteristics, because money is fungible. They are inextricably commingled with each other to the extent that there is more than one investment purchased, causing the effort to be active management. It is impossible to keep the passive component of the earnings separate from the active component

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because these components are the product of market conditions and cannot be known until after the results are analyzed.[33] The problem that one cannot distinguish reinvested income between its passive (non-marital) and active (marital) components does not cause the fund to lose its separate non-marital character. If it did, then earlier conclusions that any marital effort on investing the non-marital asset, no matter how small, converts the entire appreciation of the non-marital asset into marital property are correct. The Fourth DCA, which had been the only remaining DCA to support this theory, recently receded from it in *O'Neill* and *Chapman*. Finally, even if the earlier rulings had been correct, the fact that reinvested income is inextricably commingled with the original asset never led to the conclusion that the entire asset is marital. Why then has that reasoning been applied to certain commingling rulings to reach this result?

Creating an interspousal gift

As previously discussed, a gift is created when one establishes a presumption of a gift and fails to demonstrate contrary intent.[34] It is also created when an asset is borne from a marital debt. This occurs as a result of the equitable distribution statute.[35] If the party claiming that the asset is non-marital property can show that the loan was created solely by pledging a non-marital asset as security for the loan, then the asset is non-marital property because the asset was created with essentially non-marital funds.[36] But there is an important exception to this. When the loan is created with joint spousal liability, then the asset (equal to the loan amount) that began as non-marital property is automatically converted to a marital asset irrespective of whether the lender had a lien against a non-marital asset before granting the loan. This result occurs because, if the value of the asset as security goes south, the other spouse has a potential liability from that loan. This is an important exception to the *Farrior* ruling, which held that a margin account created solely from non-marital stock does not result in the commingling of assets with the margin loan created during the marriage.[37] If the asset is later sold to produce a profit, the entire asset is marital property. Thus, when refinancing the non-marital home is repaid from the sale of the asset, the marriage has a stake in the non-marital house equal to its repayment and any passive appreciation that accrues on that repayment to the date of divorce. When the parties refinance a non-marital house many times, the equity may become mostly marital property when the parties divorce even though the house is titled in only one name.

Conclusion

Funds are commingled when marital and non-marital moneys are combined. Two separate portions are identifiable with other non-marital assets even when they cannot be separated by distinguishing characteristics. A presumption of gifting occurs only when the title of the non-marital portion changes. The combining of funds involves this same principle. It is reasonable to presume an intended gift when one changes the title of the asset to include the other spouse. That transaction gives the other spouse control over the asset. Whether or not the other spouse exercised control is only an element of the proof of whether a gift was intended. It is not reasonable to assume an intended gift when one commingles funds inside a non-marital account. When this is done, it is because the party erroneously believes that it is his or her separate property. While it is unreasonable to presume an intended gift, it is very reasonable to presume intent to consolidate the two accounts as one. The party loses the ability to treat the combined asset as two separate funds unless he or she can prove contrary intent. This no more makes that asset marital property than paying down the mortgage of a non-marital house does. Unlike a non-marital house where the party paying down the mortgage has no choice in consolidating the

portions, when the individual does this it translates into losing the right to exclusively deduct marital expenses from the marital portion of the fund that pays the marital share. This would be similar to a party making improvements to the non-marital home using marital and non-marital cash. Since the intent of consolidation is to make the two funds operate as one, marital expenses must be deducted from both shares just as the previously mentioned contribution enhances both portions of a house.

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Endnotes:

1 *Williams v. Williams,* 686 So.2d 805, 808 (Fla. 4th DCA 1997)
2 *Adkins. v. Adkins,* 650 S.2d 61. 66 (Fla. 3rd DCA 1995)
3 *O'Neil v. Drummond,* 824 So.2d 1032, 1034 (Fla. 1st DCA 2002); *Heinrich v. Heinrich,* 609 So.2d 94, 95 (Fla. 3rd 1992)
4 *Amato v. Amato,* 596 So.2d 1243, 1245 (Fla.4th DCA 1992); *Archer v. Archer,* 712 So.2d 1198, 1199(Fla. 5th DCA 1998)
5 *Id.*
6 *Crouch v. Crouch,* 898 SO.2D 177, 182-183 (Fla. 5th DCA 2005)
7 *O'Neil v. Drummond,* supra
8 *Id.*
9 *Rutland v. Rutland,* 652 So.2d 404 (Fla. 5th DCA 1995); *Pagano v. Pagano,* 665 So.2d 370 (Fla. 4th DCA 1996)
10 *Anson v. Anson,* 772 So.2d 52, 55 (Fla. 5th DCA 2000); *O'Neill v. O'Neill,* 868 So.2d 3, 4-5, (Fla. 4th DCA 2004); *Chapman v. Chapman,* 866 So.2d 118, 119 (Fla. 4th DCA 2004)
11 *Crouch v. Crouch,* supra; *Steiner v. Steiner,* 746 So.2d 1149, 1150 (Fla. 2nd 1999)
12 *Amato; Williams; Spielberger v. Spielberger,* 712 So.2d 835, 837 (Fla. 4th 1998)
13 Lyons v. Lyons, 681 So.2d 837 (Fla. 2nd 1996)
14 Williams; Archer
15 Id.
16 Lyons
17 Crouch
18 Steiner, supra, and *Adkins,* supra, employ the same reasoning.
19 Id.
20 *O'Neil v. Drummond,* supra
21 *Id.*
22 *Jahnke v. Jahnke,* 804 So.2d 513, 517 (Fla. 3rd DCA 2001)
23 *Gregg v. Gregg,* 474 So.2d 262 (Fla. 3rd DCA); *Anson v. Anson,* 772 So.2d 52, 55 (Fla. 5th DCA); *Trant v. Trant,* 545 So.2d 428, 429 (Fla. 2nd DCA 1989)
24 Robbie v. Robbie, 654 So.2d 616 (Fla. 4th DCA 1995); *Pagano v. Pagano,* 665 So.2d 370 (Fla. 4th DCA 1996)
25 In *Chapman,* the court clarified its position in *Pagano* as fact intensive and not the result that the ruling concluded that it is impossible to separate passive from active appreciation. Yet this conclusion fails to reconcile this with what the same court meant in the earlier 1995 *Robbie* opinion. *Robbie* concluded that the trial court was free to divide the property unequally on account of the inability to separate the appreciation between its marital and non-marital values.
26 Another reason is failure to understand that interest payments are not active improvements to the property. This can easily be explained by the following: It is not reasonable to expect to find rent offered on a comparable house to be less than the full mortgage payment. Thus, the marriage receives offsetting enrichment by the value of the rent it would have to pay for a similar house. Accordingly, only the pay down of principal creates a marital component. This likely is the reasoning employed by the Second DCA in arriving at the same conclusion in *Straley v. Frank,* 612 So.2d 610, 611 (Fla. 2nd DCA 1992).
27 Compare *Gregg; Stefanowitz v. Stefanowitz,* 586 So.2d 460, 462 (Fla. 1st DCA 1991); *Reich v. Reich,* 652 So.2d 1200, 1202 (Fla. 4th DCA 1995) to *Straley v. Frank,* supra.
28 Steiner; Adkins
29 *Adkins; O'Neill*
30 O'Neill @ P. 5
31 *Id.; Young*
32 *O'Neill*; *Yitzhari v. Yitzhari,* 906 So.2d 1250, 1254 (Fla. 3rd 2005)
33 One separates the two by questioning what could be earned in the open market without effort, i.e., by turning over the decision making process entirely to a broker. Performance averages could be established using certain indexes like the S&P 500. All earnings below that level are passive appreciation irrespective of the amount of effort because they resulted from market conditions. Only those above that benchmark are the result of the effort and are marital. The average used in the process is determined after the investments are made, and therefore the passive component could never be segregated.
34 *See* 61.075(7) F.S.
35 *See* 61.075(5)(a)(1) F.S.
36 See 61.075(5)(b)(1) F.S.; Also see *Farrior v. Farrior,* 736 So.2d 1177, 1178 (Fla. 1999)
37 *Id.*